

Report to the State of Iowa General Assembly

# SF 2088 CONVENIENCE FEES ANALYSIS AND RECOMMENDATIONS - Updated



November 16, 2011  
Department of Administrative Services  
Information Technology Enterprise

## Foreword

I am pleased to present this further analysis of our January 13, 2011 Report on Convenience Fees to the Iowa Legislature State Government Efficiency Review Committee.

That study was undertaken by the Department of Administrative Services Information Technology Enterprise, in the absence of a State Chief Information Officer, in an effort to present alternatives to the current procedures used to recover the costs of providing online payment service through assessment of transaction fees.

This paper analyzed the costs to the State and the citizens of the various recommendations made in the January 2011 study as guidelines for Legislative consideration.

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## Executive Summary

As an expansion of SF2088, the Department of Administrative Services-Information Technology Enterprise (DAS-ITE) was asked to further analyze the potential costs and savings if the current practice of charging credit card and overhead fees (“value-added fees”) were to be eliminated. Value-added fees reflect the costs an agency incurs while providing online services, and those costs will always exist.. DAS-ITE researched these costs and identified ways of making the associated fees less burdensome to the citizens of Iowa. The three alternatives provide different ways in which agencies can recover those costs; they could be borne by either an annual appropriation or adjustment of the online service “price” to include the fees within the cost of the online transaction. An additional alternative is presented to leave the current value-added fee practices in place.

Recognition must also be made of the fact that traditional forms of conducting business with the State of Iowa, face-to-face and paper-based transactions, are inherently more costly. These delivery channels are effectively subsidized by the agency as a “cost of doing business” and the associated expense of the transactions is not passed on to the customer.

## Scope

This study was intended to evaluate alternatives to what are commonly termed “convenience fees”, or those fees *in addition to the statutory fee*, that an agency charges for a good or service. However, that term is somewhat ambiguous and has a different meaning within the credit/debit card industry. To reduce confusion, we will instead focus on the reduction or elimination of “value-added fees” which are fees charged for conducting a transaction that are, *in addition to the statutory fee*. Iowa Code: 8A.201(7) defines “*Value-added services*’ as services that offer or provide unique, special, or enhanced value, benefits, or features to **the customer or user** including, but not limited to, services in which information technology is specially designed, modified, or adapted to meet the special or requested needs of the user or customer; services involving the delivery, provision, or transmission of information or data that require or involve additional processing, formatting, enhancement, compilation or security; **services that provide the customer or user with enhanced accessibility, security or convenience**; research and development services; and services that are provided to support technological or statutory requirements imposed on participating agencies and other governmental entities, businesses, and the public.” *(emphasis added)*

## Background

Section 22 of SF 2088 specifies that: “*The chief information officer of the state shall conduct a study concerning convenience or other handling fees charged by state agencies by credit or debit card or other electronic means of payment. The goal of the study would be to encourage the elimination of such fees wherever possible. The department shall determine the extent and amount of the fees charged, revenues generated by those fees, and explore ways to reduce or eliminate the fees. The chief information officer shall submit a report to the general assembly by January 15, 2011, concerning the results of the study, including any recommendations for legislative consideration.*”

In the absence of an appointed State Chief Information Officer, the DAS-ITE conducted a study of those fees charged by state agencies for online services. The findings, which were presented to the Legislature in a report dated January 13, 2011, identified three alternatives:

**Option 1: Make an appropriation to the State Treasurer’s Office** for the estimated amount sufficient to cover the annual cost of all potential executive branch credit card fees.

**Option 2: Build value-added fees into the cost of goods or services.** By allowing Executive Branch agencies to include these costs in the price charged to reflect the statutory amount to be charged plus calculated, supportable costs (e.g., credit card fees, DAS-ITE ePayment system fees, processing costs, the cost of the system providing the online service, etc). Periodic adjustments will be permitted through Administrative Rules or some other pre-defined process that allows for transparency and public comment.

The agency would periodically review the added fee in relation to actual costs and propose adjustments to maintain break-even operation. Upon approval, the new rate would be implemented. Agencies could offer a cash discount that reflects the reduced transactional costs incurred when using cash-equivalent payment methods.

**Option 2a: Build value-added fees into the cost of goods or services and charge more for not using online services.** Paper-based transactions, or transactions involving the submission of hardcopy applications and payments, are more costly for an agency to process than the same transaction conducted electronically. Yet by

increasing the user fees to use the more cost-effective online delivery channel, agencies continue to drive citizens into using the more costly paper-based delivery channel.

The Board of Medicine charges a higher licensing fee for those applicants who do not apply online. This reflects the reality that it takes significantly more staff time to open and route the application, enter data from the hard copy into the system, process, apply and collect payment, and mail back the associated documents than it does to process the application electronically.

**Additional Option: Make no changes.** In our January 13, 2011 report, we noted that **a number of surveys conducted nationally and within Iowa indicated citizen acceptance of value-added fees.** In light of these findings, consideration should be given to the cost avoidance gained by continuing with the current value-added fee practices. It should be noted, however, that existing card issuer rules present problems to agencies as they require the value-added fee to be a fixed amount and not a percentage of the transaction amount. As a result, an agency has to charge the same value-added fee on a \$50 transaction as on a \$500 transaction although the credit card fees charged by the credit card provider are a percentage of the transaction's dollar value.

## Analysis

### Why do value-added fees exist?

Each of us pays the equivalent of a value-added fee every time we shop at an establishment that accepts credit cards. Card issuer regulations prohibit merchants from identifying the cost of credit card transactions, which forces them to imbed that cost into the price they charge the consumer.

State agencies do not have this option because the fee for a service, such as a professional license, is set by statute and that statute usually directs the entire fee into the State's General Fund (Iowa Code 8A.222 Financial transactions). This leaves the agency with the resultant costs and no available revenues with which to pay those costs. The value-added fee provides agencies with a means of generating cost recovery and retaining the funds within their operating accounts.

### What costs comprise a value-added fee?

<p style="text-align: center;"> <b>Card Provider Fee</b>  <b>+ ePayment Gateway Fee</b>  <b>+ Cost of Providing Online Payment</b>    <b>= Value-added Fee</b> </p>
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A value-added fee is comprised of three components:

- The credit card provider fee. This is the fee charged by the credit card issuer (i.e., MasterCard, VISA, Discover) and is a percentage of each transaction's dollar value. These are consolidated by a credit card services provider and billed to the Treasurer's Office.
- The ePayment Gateway fee. This fee has two components, the Redirected Service Fee and DAS-ITE ePayment Fee.
  - The Redirected Service provides for 3<sup>rd</sup> party handling of credit card information. Usually referred to as a "shopping cart" model, it removes the liability associated with credit card information



## Option 1: Make an annual appropriation to the State Treasurer's Office

### Credit Card Provider Fees

In FY11, the State paid \$378,012 in credit card fees to various credit card service providers for all Executive Branch agencies, or 2.04% of all gross sales. These fees for the most part, were passed to online customers – the citizens of Iowa.

Covering this cost through appropriation would save the individual customer the fee, but transfer that burden to all taxpayers. The final cost would remain the same except it would now be spread over all Iowa taxpayers rather than just those customers, both Iowa and non-Iowa residents, making credit card payments for the online services.

### ITE Gateway Feed

There were 172,037 Executive Branch transactions processed through ITE for FY11. The per transaction fees combined with the \$95 per merchant monthly result in a total gateway fee of \$121,372 per year.

### Cost of Option 1

Considering the fees for credit card providers plus the DAS-ITE gateway, the annual cost to agencies to provide online service (not including the cost associated with maintaining an online services application) is \$378,012 + \$121,372 or \$432,414. Therefore, the recommended annual appropriation is \$750,000, to be reevaluated annually and adjusted based on data provided by the Treasurer's Office. It should be noted that this does not cover the agency's cost of providing and maintaining the online service.

This option proposes an annual appropriation in an amount sufficient to cover one year's fees, plus a reasonable amount to cover unanticipated fee increases or additional customer activity. The Department of Revenue, Board of Regents and its institutions, and the Judicial Branch would be exempted from this arrangement.

### Cost to Implement Option 1

The Treasurer's office currently handles payment of the credit card fees and billing back to the respective agencies. By creating a fund for the Treasurer's office to pay these fees directly, the work involved in invoicing agencies would be eliminated.

## Option 2: Allow Executive Branch agencies to build value-added fees into the cost of goods or services

### Credit Card Provider Fees

In FY11, citizens conducted 208,254 transactions with Executive Branch agencies with a total value of \$18,533,069. These transactions generated credit card provider fees of \$378,012.

### ITE Gateway Feed

There were 172,037 Executive Branch transactions processed through DAS-ITE for FY11. The per transaction fees combined with the \$95 per merchant monthly result in a total gateway fee of \$121,372 per year.

### Cost of Option 2

In order to recover credit card provider and DAS-ITE gateway fees assessed on the annual sales of \$18,533,069, these transactions would need to increase their combined price by \$499,384 or 2.7%. As each item varies in price and credit card provider fees vary, each agency would need to analyze their per item cost and adjust the online price accordingly. The final cost to citizens would increase but only those citizens utilizing the online service would bear the cost.

As noted above, each agency would periodically review the adjusted fee in relation to actual costs and propose adjustments to maintain break-even operation. Upon approval, the new adjusted rate would be implemented. It should be noted that this does not cover the agency's cost of providing and maintaining the online service, though adjustments to include those costs could be done easily.

### **Cost to Implement Option 2**

Each agency online services application would need a minor internal programming modification to add the cost of the online service to the customer. Assuming this would take one hour to complete, the cost for all 43 applications can be projected to be 43 hours or \$5,117. There would also be a small cost to reassess the fees annually.

### **Option 2a: Allow Executive Branch agencies to build value-added fees into the cost of goods or services and charge more for not using online service.**

Most governmental agencies operate under the same challenge; the cost of service delivery through traditional channels (face-to-face or paper-based transactions) is not considered. Because of its relatively recent introduction, the cost of on-line computer applications and transaction fees are easily identified. Traditional channels, however, have existed for such a long time that their costs are much more difficult to quantify. For example, the cost of processing a paper check is estimated to be approximately \$11, but no "transaction fee" is charged to the payer for the agency's cost of accepting that payment form.

This option allows agencies to more accurately reflect the true cost for each transaction channel they provide and allow the end user to bear the cost associated with their choice. This would encourage citizens to utilize the most cost-effective means of conducting business with the State of Iowa while having those that choose other options bear the cost of those less efficient channels.